Framing a Fiscal Fix-Up:
Options for Strengthening the Finances of Western Canada's Big Cities

A Western Cities Discussion Paper

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INTRODUCTION

"...we are left with a hard, plain truth. Societies and civilizations in which the cities stagnate, don't develop and flourish further. They deteriorate." (Jacobs 1984, 232)

With these words, Canadian urban theorist Jane Jacobs concluded *Cities and the Wealth of Nations*, a seminal work on both the nature and importance of cities to regional and national prosperity. Her thesis is as straightforward as her final sentence – the financial and economic health of cities constitutes the heart and soul of any nation's standard of living.

As the world becomes increasingly interconnected by trade and the economic competition it encourages, traditional political borders conceived around the concept of the nation-state are giving way. Instead, local conditions such as the health and livability of cities are becoming more important. Decisions about investment are now being driven less by traditional notions of comparative advantage (natural resources and proximity to markets) and more by the ability of local communities to attract talent that can locate anywhere in the world to do almost anything. If Canadians are concerned about their future economic prospects, their standard of living, and ways to enhance the social fabric of the country, then they must ensure that their cities are highly livable, well operated, and appropriately financed.

PURPOSE and METHODOLOGY

In October 2001, Canada West Foundation released *Dollars and Sense: Big City Finances in the West* (Vander Ploeg 2001a). The report sought to shift the debate over public finance away from federal and provincial concerns with tax reductions and increased health and education spending to the fiscal problems confronting western Canada's largest cities. The study indicated that western cities have come under significant fiscal pressure.

Understanding the challenges facing our cities is a necessary first step, but the discussion needs to move further. What are the alternatives available to place western cities on a more secure financial foundation? This paper is intended to help answer that question by stimulating debate on the various options that are available to meet the fiscal needs of the West's big cities. It brings together the alternatives suggested by city governments, urban municipal associations, and commentators who have spent much of their professional lives considering the issues.

This study is based on a comprehensive literature review combined with ideas that have emerged at a series of recent forums and conferences held across Canada. Sources include recent books and publications, articles in policy journals, briefs published by public policy research institutes, position papers advanced by provincial and national municipal associations, and materials provided by the Canada West Foundation's Urban Finance Advisory Committee.

At the outset, it must be emphasized that some of the options will elicit strong reactions, both positive and negative. This is intentional and reflects our desire that the paper stimulate discussion. While it is unreasonable to expect unqualified support for every option, readers are reminded that each time an option is eliminated, the menu necessarily narrows.

To organize the material on this topic and help frame the discussion, the paper poses five questions:

- What are the broad fiscal challenges confronting cities?
- What is the nature of the policy environment and how does it impact on the acceptance of new ideas?
- What options have been forwarded and how would they provide cities with enhanced fiscal capacity?
- What are the primary advantages and disadvantages of each option?
- What are the barriers to implementation and what steps can cities take now to overcome some of these barriers?

URBAN FINANCE CHALLENGES

The financial stresses facing western Canadian cities are the product of two intersecting factors:

- *Rapid population growth:* From 1966 to 1996, the combined population of the seven large census metropolitan areas in the West has almost doubled, a much faster rate of growth than cities in the rest of the country (Vander Ploeg et al. 1999). In fact, five of the ten fastest growing city-regions in Canada are in the West. Population growth leads to increased demand for municipal services, places stress on a city's infrastructure, and creates demands for more investment in a city's capital stock.

- *Poor revenue growth:* From a provincial or federal perspective, population growth is not problematic as it automatically lifts government revenues. From 1990 to 2000, total per capita revenues (adjusted for inflation) collected by the federal government and all western provincial governments have increased. However, many cities in the West have seen *negative* real per capita revenue growth (Vander Ploeg 2001a). The reasons for this are two-fold. First, Canadian cities are primarily limited to the property tax, which is a less buoyant tax than personal income or sales taxes. Second, cities have had to cope with the fallout from federal and provincial deficit cutting. With the exception of Winnipeg, all large western cities have seen reduced operating and capital grants (Vander Ploeg 2001a). Senior governments have also downloaded services by shifting responsibilities without adequate financing (FCM 1998, 2000b) or vacated the policy field (City of Regina 2001). Compounding this problem is that provinces have been unwilling to significantly increase the authority of municipalities to expand revenue sources or engage in innovative means of financing (SUMA 1999, UBCM 2001, Tindal and Tindal 2000).

As a result, western Canadian cities find themselves in a "revenue squeeze." Program spending by most large western cities (in real per capita terms) has fallen throughout the 1990s, and many have been unable to finance badly needed infrastructure (Vander Ploeg 2001a). For skeptics, much of this is the direct result of events occurring in the 1990s, and are therefore relatively short-term in nature. But this misses the point. The fiscal challenges extend beyond recent belt-tightening. They are also the result of structural fiscal challenges that are becoming increasingly difficult for cities to handle given the policy tools at their disposal.

- *The presence of large and growing externalities:* Large cities are the anchors for much larger city-regions. They are surrounded by other municipalities and are hubs for the nation's transportation infrastructure. Commuters, visitors, truckers, conventioneers, and tourists continually use a central city's services but do not contribute to the residential property tax base upon which some of those services depend. Part of the rationale for conditional provincial grants is to offset these externalities or "free-rider" problems. However, grants have either been cut significantly or have not grown (Vander Ploeg 2001a). More important, the population of anchor cities is declining as a proportion of most city-regions. In 1966, for example, the City of Vancouver accounted for 44% of the entire metro area. In 1996, that figure fell to 28% (Vander Ploeg et al. 1999). Another example of a challenging externality is social disparity. Many social problems find their way into city centres, whether it is illegal drugs in Vancouver or homelessness in Calgary.

- *Urban sprawl continues to press city finances:* Sprawl increases costs for all city services, from roads and streetlighting to pumping water. The cost of sprawl has been commented on extensively since the 1960s, yet cities have been unable to gain the upper hand. The drivers of sprawl exert strong pressure, and include current zoning practices, a readily available and relatively inexpensive inventory of land, the low cost of individual transportation, rising living standards, a market for large homes, the impact of new technology, higher effective tax rates in central city cores, and the centralized financing of city services which fails to reflect the actual cost of servicing outlying neighbourhoods (Holle 1999).

The need for new policy tools and approaches is becoming increasingly evident. Europeans, Americans and Australians are investing heavily in urban infrastructure and are showing great interest in the creative capacity of urban communities. Canada, however, continues to neglect a growing list of urban needs (Gibbins 2001, Lorinc 2001, FCM 2001). Compounding this situation is the lack of agreement by many urban finance experts on traditional options such as amalgamation, varying forms of regional governance, intermunicipal agreements, tax sharing and tax pooling (Sancton 1994a, 1994b, 1999, 2000a, 2000b; Lightbody 1997, Kitchen 2000, Bish 2001, MacFarlane 2001). In other words, Canadians need to seriously rethink our cities and find agreement on new ways and means to equip them for the challenges of today's economic realities. Failing to do so presents a very real threat to national economic competitiveness and productivity.

THE POLICY ENVIRONMENT

Ideas for reforming and improving the fiscal foundation of cities have been discussed for some time, but there has been little movement. The policy environment in which cities find themselves is key to understanding this lack of progress.

- *A perceived lack of crisis:* Past municipal accounting practices have left the public unaware of the significant challenges facing cities. Public financial reports failed to reveal deficits and showed year over year increases in revenue and expenditures, as well as falling levels of tax-supported debt. Throughout the 1990s, however, many cities ran deficits when capital spending was considered, and revenue and expenditure increases were not large enough to compensate for population growth and inflation. In many cities, self-sustaining debt has not been reduced, and has even grown (Vander Ploeg 2001a). But in the collective mind of the public, there is no compelling need for change.

- *Provincial control:* Many options for reform are irrelevant because provincial legislation would prevent cities from adopting them. Specific examples might differ between provinces, but it is not hard to develop a preliminary list – toll roads, differential mill rates to reflect the varying costs of servicing properties, and special levies on certain services. The general legislative framework is one of command and control, and most provinces jealously guard this jurisdictional supremacy. Many provinces have engaged in a review of their municipal legislation (British Columbia, Alberta, Ontario, Newfoundland, Nova Scotia), but it remains unclear whether the changes will significantly increase autonomy (FCM 2001, UNSM 1998b).

- *Current policy priorities:* The focus on public finance is heavily tilted toward concerns over health and education. This pre-occupation makes it very difficult to draw increased attention to municipal issues, which have always tended to rank low on the public agenda. This myopia remains despite the fact that Canada's social programs depend on wealth creation, which is increasingly generated in large urban centres.

- *Economic uncertainty:* Current world events and the prospect of recession have strengthened the status quo. The competition for scarce tax dollars has become more intense, and options for new fiscal arrangements now have a much steeper hill to climb. Current developments are not a good argument to avoid considering solutions to urban finance issues, but they do affect the uptake of certain options in the short-term.

- *Canadian incrementalism:* A political culture marked by conservatism and general bureaucratic and institutional inertia are powerful forces that resist fundamental change in the way public business is conducted. Generally, the focus of governments is on the "quick-fix" rather than fundamental solutions which address longer-term problems.

While the financial challenges facing western Canada's big cities are powerful arguments for change, they are offset by a policy environment that is resistant. *Where can Canadians turn?*

OPTION #1: Cities must keep the focus on core responsibilities and priorities.

Municipal government exists to facilitate local decision-making with a focus on providing services to property and addressing local needs (UBCM 2001). Many analysts have articulated the position that cities need to avoid activities that have a strong income redistributive element (e.g., social services, homeless shelters, social housing). The rationale for this is that the property tax is narrow and ill-suited for such responsibilities. The role of city government is to provide services that benefit local residents and can be funded from locally-generated revenue (Kitchen 2000). It is senior governments that have access to a more diverse tax base (e.g., income taxes, sales taxes, resource taxes) plus a wider capacity to borrow. Thus, they are better suited to stabilizing the economy and redistributing income (McMillan 1997).

It follows, then, that city governments cannot be "all things to all people." While many concerns can be tagged as "urban issues" it does not logically follow that local governments are responsible for them, especially given the limited tax tools at their disposal. A strong stand on this issue has been taken by numerous municipal associations (AUMA 2001a, UBCM 2001, SUMA 1999, UNSM 1998b).

Declining levels of senior government support mean that a good part of the solution depends on the capacity of cities to focus on core responsibilities. Because of senior government downloading and offloading, cities are under intense pressure to widen their activities while they remain in a highly restrictive fiscal environment. Fiscal responsibility mandates that cities attempt to resist this trend by keeping the focus on local priorities.

ADVANTAGES

- *A focus on core competencies is specifically designed to enhance fiscal capacity:* A more limited focus helps close the structural fiscal gap that inevitably builds whenever financial resources are unable to meet expenditures that are spread over a wide range of activities. Maintaining a narrow focus helps reduce overlap between governments and boosts fiscal capacity by directing limited resources to a shorter list of essential priorities.

- *A more clear definition of roles and responsibilities enhances accountability:* Blurred lines of jurisdiction produce confusion over which government is responsible for what service. If cities were to distance themselves from the confusing web of functions provided by government, they would find themselves better able to sidestep pressures to expand expenditures. Citizens would also be able to better determine where to lodge complaints and whom to call upon for action. The result is a better understanding of the services that cities should be providing and a stronger sense of community ownership over those services (UNSM 1999).

DISADVANTAGES

- *The spectre of a steadily increasing set of urban problems:* If cities completely disengage from services oriented to "people" or "income redistribution" (e.g., homelessness or urban aboriginal issues) and the provinces and the federal government refuse to pick up where local governments have left off, it is the cities who will ultimately bear much of the social and economic cost. The presence of significant urban challenges that consistently fail to be addressed by any order of government will not contribute to the attractiveness or quality of urban life in western Canada.

- *It is easier said than done:* Despite the logic of a sharper focus, distinguishing between services that are inherently local and those that are not is difficult (Tindal and Tindal 2000). Further, many citizens do not limit the role of municipal government to simply providing local services. City hall is often seen as an institution and ally that helps uphold and communicate concerns in other policy areas unrelated to local services. For example, citizens may call on municipal officials to actively press provincial governments regarding the number of medical doctors and teachers in the city (SUMA 1999, AUMA 2001c).

BARRIERS TO CHANGE

- *Provincial Agreement:* To be effective, any process of disentanglement necessarily implies the participation of provincial governments, and they may be unwilling. If provinces are reluctant to engage in such an exercise, the scope for action becomes very limited. In effect, cities are left with the option of unilaterally declaring their responsibilities and top priorities, with no guarantee that anyone is paying attention. The province could simply refuse to accept such a declaration, and insist that cities stay engaged in certain policy areas.

- *Disentanglement is an ideal that may be difficult to apply in practice:* Today's governments are highly interconnected. Separating responsibilities can be next to impossible given the complexity and number of functions that are shared. For example, identifying the line of demarcation separating health from welfare and welfare from social housing is not at all clear (Tindal and Tindal 2000). Further, provincial and municipal roles and responsibilities are not static. Policy priorities and responsibilities evolve over time as the expectations of citizens change (UNSM 1998b).

- *Many past disentanglement exercises have not met with success:* From the 1960s to the 1990s, numerous committees, task forces, and disentanglement initiatives were launched to realign provincial and municipal service responsibilities but nothing of substance was ever implemented (Kitchen 2000). Discussions over whether local government should take care of only local services have no final answer, and those who suggest it are often told that the theoretical ideal ignores political realities. There simply is no one mode, rationale, or set of criteria for municipal financing that captures unanimous consent (FCM 1998, 2000b).

FACILITATING CHANGE

- *Set strategic priorities and ensure that other policies contribute to the broader objectives:* Big city governments provide a multitude of services and are the target of many demands. In a restricted fiscal environment, cities must not only sort through the range of issues and identify top priorities, they must ensure that other policies are not working at cross-purposes *(Discussion Box 1)*. A simple step forward would be budgeting for core responsibilities and leaving all other responsibilities for the end of the budgeting process. This approach is suggested by the Alberta Urban Municipalities Association (AUMA 2001a).

- *Continue lobbying through provincial and national associations for a more clear definition of roles:* Three principles should direct any disentanglement. First, changes should reflect the limited revenue capacity of cities (FCM 1998). Second, programs and services exclusively determined by one government should be entirely funded by that government (AUMA 2001a, UBCM 2001). Third, there should be agreement that if a city is to undertake a service more properly belonging to senior governments, it will be preceded by consultation in the decision-making process, an assessment of the fiscal impacts, and a commitment for financial compensation that will be both *predictable* and *reliable* over the long-term (AUMA 2001b, 2001d, UBCM 2001).

- *If it proves difficult to vacate an activity, limit activities to non-financial involvement:* Cities can avoid trapping themselves into certain service areas but still make a valuable contribution. For example, both Regina and Winnipeg are spurring development of denser housing in the inner city that also conforms to affordable housing criteria. Renovation and residential construction in Winnipeg's *Housing Improvement Zones (HIZ)* are eligible for infill tax credits, and certain projects qualify for the waiving of development charges, hook-up fees, and other permits. The costs are limited to foregone tax revenue and do not commit cities to a long-term expenditure (City of Regina 2001, City of Winnipeg 2000).

- *Upload certain services to the province:* A review of services would identify areas unrelated to core competency or that generate uncontrollable externalities. These could be uploaded to the province. Winnipeg has divested itself of $40 million in annual social service costs (City of Winnipeg 1999), Calgary has shed responsibility for the Deerfoot Trail freeway, and rural municipalities in Alberta no longer deal with secondary highways. Winnipeg is urging the province to now take over ambulance service in the city (City of Winnipeg 2000).

- *Avoid the temptation of senior governments bearing cheques by referring them to the non-profit sector:* In areas where direct local involvement makes little sense, cities can urge senior governments to deal directly with non-profit organizations. Community non-profits may be better positioned to undertake these activities given their specialized expertise. Senior governments are already funding native friendship centres, multicultural organizations, local immigration societies, and homeless shelters. If this approach were expanded, cities could better focus on their core competencies. The benefits are obvious in that real social concerns would be met while a vibrant non-profit sector would be strengthened (Gibbins 2001). To be sure, non-profits are not a panacea for all urban woes, but their contribution is growing and they provide a nice fit with the notion of community-based solutions.

DISCUSSION BOX 1: Ed Tel and Enmax

The potential sale of Enmax, Calgary's electrical utility, was a hotly contested issue in the 2001 civic election. The idea to sell was prompted by deregulation of Alberta's electrical industry and city administration's warning that significant infusions of capital would be needed to keep the utility competitive. The potential sale sparked a strong reaction from citizens and candidates in the election, and the new Council shelved the idea.

Contrast this with Edmonton. In 1994, that city sold its telephone utility. The same factors were at work – deregulation and the prospect of massive investments to stay competitive. In a highly emotional environment, the City sold the utility to Telus, which produced a one-time dividend of $470 million along with the shedding of $178 million in debt. The EdTel Endowment (which received the proceeds of the sale) has earned $336 million since 1995. Of that amount, $107 million was reinvested and $229 million was used to support programs and capital. When compared to total revenue, the size of the EdTel Endowment approaches the same magnitude of Alberta's Heritage Savings Trust Fund.

A focus on essential priorities would help determine appropriate policy with respect to Enmax. A key priority for Calgary is transportation infrastructure. Does holding on to a former public monopoly fit with the pressing needs of the city? Or would selling Enmax to create a pool of own-source capital funding make more sense? While the decision should involve the citizens of Calgary, the City needs to realize that fiscal prudence demands policies that reinforce one another, not policies that take off in different directions.

SOURCES: Vander Ploeg 2001a, 2001b.

OPTION #2: Cities should set correct prices for their services.

If a focus on core competencies speaks to *what* cities should be doing, correct pricing speaks to *how* they should be doing it. Over the last decade, the "benefits model" of taxation and "user pay" has emerged as a potential solution. The idea is very much an outgrowth of public choice theory. The thrust of the model is that individual users of municipal services pay the actual costs of providing the services. This would generate efficiency by linking price to cost (Holle 1999, Palda 1998a, Kitchen 1993, 2000, 2002b).

Proponents of the benefits model argue that there are three fundamental problems with how cities finance themselves. First, the current approach is heavily tilted toward centralized financing, where revenues are thrown into a "pot" (the general revenue fund) and then spread out with no financial consequences accruing directly to individuals (Palda 1998a). Paying for services out of general taxes leads people to believe that services are somehow "free." Because the costs are shared, there is no incentive to reduce consumption. The lack of individual pricing leads to higher costs and continual demands for more services than are really necessary (Groot 1995). Centralized financing can produce distortions that redistribute income and benefits. Individuals who consume fewer services subsidize those who consume more (Frampton 1989). Accountability is muddled – no one knows who is being subsidized, to what extent they are being subsidized, and by whom they are being subsidized. If the real nature of this redistribution were known, many would find it unacceptable (Kitchen 1993).

Second, user fees are not being employed as a price signalling device. Many user fees do not capture the full cost of providing some services (e.g., recreation centres, libraries). Where user fees do produce full cost recovery (e.g., water and sewer utilities), the price charged reflects the "average cost" but not the "marginal cost" of the last unit consumed. Further, many municipal user fees do not take into account the costs of providing services during peak demand periods. In other words, user fees are employed to raise revenue only, as opposed to accurately pricing the costs of municipal services (Kitchen 1993).

Third, property taxes do not reflect the variable costs of providing municipal services to different properties. Properties of similar types are assessed the same and an identical mill rate is applied regardless of the varying costs associated with delivering services to the properties. Providing services to homes in far-flung suburbs is more expensive than provision to homes closer to the city centre (Holle 1999). Compounding this problem are the differential assessments and mill rates applied to different classes of properties. Generally, multi-family residential properties are taxed higher than single-family residential properties, and commercial and industrial properties are taxed at a higher rate than residential properties (Kitchen and Slack 1993, UNSM 2001, Kitchen 2000). To be sure, lower effective residential tax rates may only provide an illusion of shifting taxes to businesses – the extra cost of the higher business taxes could be passed on to consumers. But this may not always be the case (Kitchen and Slack 1993, Kitchen 2000). But even if business taxes are recouped from customers, the current approach to property taxation does not constitute a direct link between taxes paid and the costs of municipal services consumed. Many urban economists argue that this has led to over-consumption and higher costs (Kitchen 1993, 2000). It also promotes sprawl by subsidizing the real costs of living in the suburbs (Holle 1999).

This approach to funding needs to be reconsidered if cities are to secure their fiscal future. An efficient allocation of a service can only be attained when price equals the marginal cost of producing it. If prices are too low or too high, scarce resources are wasted (Parkin and Bade 1997). According to many urban finance experts, most municipal services are under-priced and are therefore inefficient. But cities are operating in a radically new fiscal environment that places a premium on efficiency. Cities are becoming more dependent on own-source revenue. Global competitiveness is also increasing. An inefficient public sector amounts to over-taxation, and this has repercussions that affect the private sector's ability to compete. Public resistance to property tax increases and pressures to avoid debt are also creating strong incentives for increased efficiency (Kitchen 2000). If efficiency is a worthwhile goal, then taxation and user fees must begin reflecting the costs of city services. This would limit over-consumption and the growing gap between revenue and demands for increased expenditure *(Discussion Box 2)*.

ADVANTAGES

- *User pay meets the three criteria of effectiveness, efficiency and equity:* User pay produces *equity* in that people are paying for what they consume. User pay is *efficient* in that it provides the right amount of service for the right price. User pay is also *effective* in that services are readily available. It is no accident that user pay governs most of our daily life, from buying milk to purchasing long distance telephone service (Walker 1993).

- *User pay bridges the growing gap between increasing demands for expenditure and limited revenue by signalling to citizens and consumers the costs of municipal services:* User pay is not about raising revenue, achieving full cost-recovery, cost-effectiveness or cost-containment. From an economic perspective, user pay is about pricing and capturing the real costs of providing services to individuals and property owners in an attempt to increase efficiency and discourage the wasting of expensive services (Kitchen 1993, 2000). It lessens the "free-rider" problem, helps stem urban sprawl as life in the suburbs becomes more expensive than living closer to the city centre, and provides cities with an escape route from the "revenue squeeze."

- *User pay dispels the myth that public goods are free:* User pay creates a new fiscal dynamic in cities as people will seek to avoid "taxes" by cutting back on their consumption of services, whether that be lowering the amount of garbage they throw out or limiting the amount of water they use by inserting toilet tank infills or low-flow shower heads (Palda 1998a). The savings could run into the millions of dollars as cities suddenly discover there is no demand for that new water treatment plant afterall.

DISADVANTAGES

- *If a gain in efficiency is the prime advantage of correct pricing, then a loss of distributional equality is the prime disadvantage:* User pay pricing is alleged to be regressive. While it provides for *equity* (you pay for what you consume), it does not automatically translate into *equality* (universal access and/or prices that are proportionate to income). The struggle for pricing is wrapped up in the "big" economic trade-off – efficiency or equality but never both (Parkin and Bade 1997, Oakerson 1999, Luciani 1996).

- *User pay for some public goods and services can create new problems:* For example, if solid waste collection is removed from general tax revenue and converted to user pay, some people may try to avoid the "tax" by illegally dumping garbage. In the case of transit, buses and trains could empty out as people revert to the solitude of their cars for which no user charges apply. Thus, a "complete" pricing system or other counteractive mechanisms could be necessary to avoid such distortions. The essential point is that the pricing of public goods is not as simple as attaching a number – it carries other implications.

DISCUSSION BOX 2: Pricing Transportation

"In no other major area are pricing practices so irrational, so out of date, and so conducive to waste as in urban transportation." (Palda 1998a, 20)

Traffic congestion and the costs of subsidized transit are perennial urban challenges directly linked to the lack of pricing. Currently, the costs of driving on city roads are not directly recovered by the individuals using them, but are paid from tax revenue. This lack of pricing means the only other option to limit demand is queuing – the traffic jam. Congestion exacts an economic cost through higher transaction costs for business, air pollution, urban sprawl, continual demands for more "free" infrastructure, and unprofitable transit that must compete for clients who do not pay the full costs of their driving.

Current options to end congestion revolve around more money for infrastructure (transferring a portion of provincial or federal fuel tax revenue, higher parking fees) and creating high occupancy vehicle (HOV) lanes. These options are entirely unrelated to the real problem, which is congestion. However, establishing tolls on major arteries in and around cities with variable rates that increase during rush hour periods (and decrease at other times) would ration road usage, limit congestion, and place transit on a better financial footing.

Congestion pricing is already used in several industries like telephone service, where individuals are charged higher rates for long distance during peak periods. The intent is to sort out those who need the service from those who can wait or who have access to alternatives. Faced with the actual cost of using roads, drivers might begin opting for more efficient and lower cost options such as transit or car pooling.

Road tolls would end the "free-rider" problem of those in bedroom communities and suburbs who "commute and pollute" their way into the city. Like the correct pricing of all services, road tolls would help contain sprawl by reflecting the real costs of living in the suburbs. Given new electronic technology, cars can be fitted with transponders that allow the tolls to be collected and paid through tags attached to sun visors or windshields.

The use of toll roads in Canada are limited to a few examples such as the Coquahalla highway in BC. Highway 407 near Toronto is another example. The 407 takes tolling a step further. The highway is privately owned and operated by SNC Lavalin, a large engineering firm in Montreal. Many U.S. and European cities are increasingly using tolls to pay for construction and to limit the environmental and fiscal damage produced by the "free" road. At the same time, road tolls attempt to price a good with highly public characteristics. This can create other unwanted problems, such as more traffic in residential areas that are not tolled. Innovative ideas to limit these sorts of unintended circumstances would also be needed.

SOURCES: Gjertsen 1995, Samuel 1995, O'Donnel 2001, Palda 1998a, 1998b.

BARRIERS TO CHANGE

- *The status quo is heavily defended on the grounds of distributional equality:* In the minds of the public, efficiency is something for business to worry about. Government is to concern itself with the public interest (Oakerson 1999).

- *The issue is surrounded by interests with significant sums at stake:* The property tax is highly visible and this works effectively against proposals for reform. Residential taxpayers know how much tax they pay and will resist any attempt to increase the amount by lowering the burden on business. Shifting the tax burden to suburban properties and away from properties closer to the city centre is even less likely. The fact is, people vote and businesses do not (Kitchen 1993), and the suburbs contain the single largest bloc of voters.

- *Municipal officials agree that correct pricing is a laudable goal, but arriving at the costs of many services is difficult:* A range of soft costs are often shared across service functions (e.g., overhead, buildings, insurance, training, office support), making cost accounting difficult (Parsons 1994). Centralized financing is easier, and politicians like the approach. Centralized financing creates specific constituencies that accrue a set of concentrated benefits, but the cost of those benefits are widely dispersed across the taxpaying public. This allows politicians to appeal to a range of beneficiaries for votes (Palda 1998a, Trebilcock 1994).

- *Provincial approval would likely be required:* Local assessment practices, the range of services to which user fees can be applied, and the level of user fees are often controlled by the province. In 1993, for example, the Ontario Fair Tax Commission suggested that local solid waste disposal should be provided through general tax revenue rather than user fees (Palda 1998a). Not all of the proposals emerging from this commission were enacted, but the general thrust demonstrates the degree of control often sought by provinces.

- *Traditional methods of financing exert strong control:* The current property tax system has a long history and the market seems able to bear the inconsistencies in effective tax rates. Renters of multi-family dwellings are likely unaware of how their taxes subsidize the costs of suburban growth, and many citizens also continue to hold onto the erroneous belief that commercial and industrial property owners can always recover their higher property tax burden by shifting it to consumers outside of the city through higher prices of goods and services provided (Kitchen 1993, 2000). For many people, then, there is no compelling need for property tax reform.

FACILITATING CHANGE

- *Cities should make rational pricing through expanded user fees and property tax reform a long-term objective.* The argument of pricing services to contain sprawl and end the over-consumption of services is compelling. But political realities are sure to intervene. As such, the approach must be one of gradual change. City officials could start first by expanding user fees to cover more services and at the same time making a firm commitment to a gradual reduction in property taxes. Variable effective tax rates that reflect the differing costs of providing services is more difficult. A compelling case for the change must be developed and repeatedly articulated over the long-term.

- *New techniques in cost accounting and activity-based accounting provide cities with an opportunity to begin collecting information on the costs of various services.* Cities across Europe and the United States that are pricing many of their services have developed complex pricing models to measure costs (Goldsmith 1998). The transfer of this knowledge is a prerequisite to moving further down the road to a user pay system. Cities should be actively investigating the experiences of international cities with various pricing strategies, and the benefits and pitfalls involved.

- *Cities can begin identifying all services that could eventually be converted to user pay as opposed to centralized financing.* Goods and services that provide private benefits and generate few spill-overs (e.g., water, sewer, recreation facilities, libraries, museums, solid waste service) are the best candidates for correct price setting through user fees (Kitchen 1993). The City of Winnipeg is currently engaged in such a process, and is reviewing all of its 195 services to identify which ones can be accurately priced and even serve as candidates for delivery outside of government (City of Winnipeg 2000). Once these services have been identified and costs determined, a next step would be to pull them from the general operating fund and begin running them as independent business units, much like municipal utility operations.

- *Begin aligning the interests that will benefit from user pay and property tax reform.* Political and economic changes of this magnitude are only possible when a coalition emerges to challenge the status quo. At first glance, such a coalition seems almost laughable. However, imagine the moral argument flowing from a group comprised of lower and modest income groups, business leaders, and environmentalists. While these groups have traditionally possessed conflicting goals, their interests converge in a very unique way when it comes to urban finance questions *(Discussion Box 3)*.

DISCUSSION BOX 3: A Coalition for Change

Typically, lower and modest income individuals reside in multi-family dwellings while middle and upper income individuals reside in single-family dwellings. Multi-family dwellings usually carry a higher effective tax rate (though the total tax bill may be lower) than a single-family dwelling. Lower and moderate income groups also tend to locate in belt-line areas surrounding the central core. Because many city services (e.g., water and sewer) are more expensive to deliver to the suburbs than to areas closer to the city centre, and many user fee services employ "average-cost" pricing, lower and moderate income groups arguably subsidize the suburbs. Arguably, middle and upper income property owners also use more city services – they are the ones with the large lawns to water not those living in apartments or small townhouses.

In addition, much tax-supported capital infrastructure (e.g., road construction, streetlights, sidewalks) directly benefits new construction in the suburbs, but not areas closer to the core. Through centralized financing, lower and moderate income groups are subsidizing suburban development. This reverse "Robin Hood" is a powerful incentive for lower and moderate income groups to join a coalition for change. To be sure, subsidization also flows in the other direction. These inequalities could be counteracted by structuring a user fee system that provides rebates for lower income groups through a direct transfer without removing the efficiency incentives that user fees provide.

Business leaders would also be interested in a coalition. The business property tax is unrelated to profit and their ability to export the tax depends on the nature of the market and the products they produce. A reduction would be welcomed.

Environmentalists would round out the group. Sprawl and the over-consumption of services generates very real ecological costs – wasting of water, excess sewage, high volumes of garbage, and air pollution produced by the daily commute. In an article written in the *Globe and Mail* (April 4, 2001) former Toronto mayor David Crombie explains that a unique coalition is driving urban change in the United States:

"The ideas behind smart growth were not new. What was new was the emergence of unusual coalitions of interests. Suddenly, the Sierra Club, the National Association of Home Builders, and the Urban Land Institute found themselves using much the same language and promoting some of the same goals."

SOURCES: Kitchen and Slack 1993, Holle 1999, Pakda 1998a, Kitchen 1993.

OPTION #3: Cities need to become more efficient by adopting alternative service delivery (ASD) options.

While correct pricing would be beneficial, some argue it is only a partial solution. Correct pricing coupled with alternative service delivery (ASD) models offers cities an even greater potential for cost savings and increased efficiency. Before discussing how alternative service delivery systems work, two points must be stressed. First, ASD is not about the standard efficiency drive, whether that be rationalization, bulk purchasing, total quality management or injecting private sector stratagems into the public sector. Seldom do such efforts succeed (Parsons 1994, Seidle 1993). Second, ASD is not privatization. The matter is not about whether the private sector is inherently better than the public sector (Goldsmith 1998). Rather, the real issue is monopoly service provision (Love and Cox 1991, Kitchen 1993).

Currently, local governments are monopoly providers of numerous municipal goods and services. The rationale behind monopolistic service delivery is that such services are either public goods and therefore must be provided with public monies, or they possess such massive economies of scale that there is room for only one production agent. But in many instances, local governments are monopolizing the provision of services that possess private characteristics or small economies of scale. For example, research has shown that up to 80% of all municipal services may not possess economies of scale (Bish 2001). In fact, many local services actually possess diseconomies of scale where long-run average costs rise as output increases. Typically, services that are labour intensive (e.g., solid waste disposal) possess diseconomies of scale while capital intensive and specialized services (e.g., water supply and distribution) have large economies of scale (Bish 2001).

The problem with monopoly service provision is the lack of competition in the system, which leads to a lack of incentives for efficiency and productivity (Parsons 1994). The result is higher costs. Delivering services with diseconomies of scale over a large urban area through a public monopoly makes little economic sense, even if a large unified city has the bureaucracy, personnel, and equipment to accomplish it. Even for those services that actually do possess large economies of scale, it is possible to introduce competition into the system through ASD models that could result in substantial cost savings and improved efficiency.

ASD is focused on the introduction of competition and incentives for the purpose of improving efficiency and productivity. To accomplish this, ASD requires the splitting of the provision of a service from the actual production of a service. An entity's ability to ensure a service is provided and its ability to efficiently produce that service are different matters (Oakerson 1999). Provision of a service speaks to the quantity and quality of what will be produced, decisions about how it will be produced, how costs will be recovered, and what standards will apply. Ability to produce refers to an entity's capacity to effectively and efficiently deliver a service. ASD recognizes that governments are well placed to ensure provision, but not necessarily production. ASD has the public sector competing with the private and non-profit sectors for the rights to deliver a local government service based on who can do it the most effectively and efficiently thereby lowering costs.

ADVANTAGES

- *The primary advantage of ASD is lower long-term costs.* Numerous studies comparing the costs of public and private sector delivery of city services have been conducted in the United States, Canada, and across Europe (Bish 2001, Institute for Saskatchewan Enterprise 1990, Walker 1988, Kitchen 1993.) Depending on the activity, private production can yield savings in the range of 15% to 30%, with occasional savings of 50% (Love and Cox 1991). However, these cost differentials between private and public delivery largely disappear when ASD models require public sector agencies to compete with private sector providers (Trebilcock 1994). Research suggests that the savings are not driven by lower wages or the issue of unionized versus non-unionized employees. Rather, the savings accrue from increased employee productivity produced by lower staffing levels, the adoption of newer technology, and innovation (Kitchen 1993, Trebilcock 1994, Institute for Saskatchewan Enterprise 1990, Walker 1988). While the public sector assigns wages based on factors such as job classification schemes and tenure, competition results in wages tied more directly to performance (Parsons 1994).

- *ASD is not a new concept.* Competitive contracting is a well-established practice in many small towns and cities across Canada and the United States. Some cities are essentially contract-towns, where most services are purchased rather than produced (Institute for Saskatchewan Enterprise 1990). In large metropolitan centres, however, the use of competitive contracting is typically restricted to a narrower range of activities, primarily the construction of city infrastructure and

facilities (Walker 1988, Institute for Saskatchewan Enterprise 1990). A complete explanation for this remains elusive. It has been suggested that smaller cities, lacking fiscal capacity, competitively contract to secure lower costs. Larger metropolitan centres, on the other hand, have more financial resources, a broader service area, a larger bureaucracy, and a stronger union lobby. All may contribute to a tendency toward monopoly control.

- *ASD can give economic development a boost:* Cost savings, the potential for a lower tax burden, and increased opportunities for the private sector can make a significant contribution to local economic development. International experience with ASD indicates that the private sector responds well to invitations to compete with the public sector. This stimulus encourages the formation of new businesses that spur job creation.

- *ASD provides for decentralized service delivery and emphasizes community and neighbourhood:* Monolithic service delivery in large metropolitan centres cannot easily accommodate the diversity of demands for different service levels emerging from different communities and neighbourhoods. ASD provides opportunities to limit the "one-size-fits-all" policy. To accomplish this, ASD requires that large metros be divided into geographical service areas, and opportunities are then provided for the public and private sectors to compete for the rights to deliver services in those areas. Montreal was one of the first cities in the world to experiment with this aspect of ASD by dividing the city into 180 specific service areas (Institute for Saskatchewan Enterprise 1990).

DISADVANTAGES

- *Despite claims to the contrary, alternative service delivery is no panacea:* The best candidates for ASD are those services where costs can be determined, performance standards established, and outputs measured (Kitchen 1993, Trebilcock 1994). Competitive contracting through ASD requires the development of tender specifications as well as continual monitoring to ensure service standards are being met. Not all city services easily lend themselves to this form of rigorous analysis.

- *Translating theory into practice can be a difficult task:* For competition to exist, several conditions must be met including a large number of buyers and sellers, clear information, choice, and no limits on entry into the market (Parkin and Bade 1997). Governments can offer choice and remove entry barriers, but it is more difficult to affect the number of potential suppliers. In addition, governments themselves need to ensure that public-private competition is taking place on an even field and that the conditions for competition are continually satisfied over the long-term. Regular bidding for the rights to deliver a service are meaningless if a small group of public or private contractors consistently win bids because they have consolidated control. This is a perennial challenge facing governments, although it is easier to manage in large metros than in small towns and cities (Institute for Saskatchewan Enterprise 1990).

- *ASD carries other logistical problems that require constant vigilance:* Service quality and monitoring are a constant concern whether services are delivered in-house or competitively contracted through ASD options. At the same time, ASD can bring additional problems in the form of contract administration and break-downs in communication with private providers. These irritants, however, are mild when compared to other threats such as failed service contracts, price rigging through collusion, "sweetheart deals," corruption, and kick-backs (Oakerson 1999).

BARRIERS TO CHANGE

- *Public perceptions and fears:* Many citizens continue to hold onto the traditional notion that only a public monopoly can deliver government services. There is also the fear that service quality will fall under competitive contracting, despite the myriad of research pointing in the opposite direction (Parsons 1994, Institute for Saskatchewan Enterprise 1990, Walker 1988, Pirie 1987). In the minds of the public, alternative delivery is often equated with privatization and its many ideological overtones.

- *Public sector unions are highly resistant:* The spectre of lay-offs, wage reductions, and the elimination of benefits causes both union leadership and its membership to reject efforts of implementing new ways of delivering municipal services.

- *Public sector managers often oppose such measures:* In many ways, managerial and bureaucratic resistance presents a stronger barrier than union reluctance. The tendency of bureaucracies to be self-perpetuating is well-documented. Breaking the bureaucratic attachment to the status quo and the financial and psychological investment in existing strategies and policies can be difficult. Bureaucracies tend to work towards maintaining the prevailing organizational culture by rejecting ideas that could disrupt the equilibrium of power and influence (Seidle 1993).

- *Provincial restrictions may stand in the way:* The Task Force on Urban Government Renewal of the Saskatchewan Urban Municipalities Association stated that municipal leaders were not opposed to implementing alternative service delivery options, but provincial restrictions often formed a wall preventing the adoption of some ASD options (SUMA 1995). In the United States, the federal and state governments are beginning to tie grants and offer bonuses to cities that are implementing new ideas and encouraging "smart growth." While some of this has occurred in Ontario, it is not a defining feature of the western Canadian urban landscape.

FACILITATING CHANGE

- *Cities could take a step forward by creating a vehicle to share information and best practices in alternative service delivery:* In 1995, the Saskatchewan Urban Municipalities Association called for the creation of an innovation exchange that would serve as a clearinghouse for information and strategies relating to alternative service delivery. The intent was to give cities access to emerging trends and information on benchmarks, best practices, strategies for implementing various options, and examples of successes and failures (SUMA 1995). The idea reflects the fact that reinventing government is not a single event, but a continuous process of innovation.

- *Cities should begin building the case for ASD by communicating that the search for better and more cost effective civic services is a top priority:* In many ways, cities are well-placed to build momentum for alternative service delivery because it provides a good fit for many municipal services *(Discussion Box 4)*. Since senior governments have shown less interest in ASD since the recent fiscal turn-around, there is also a vacuum into which cities can easily step. This would allow cities to start driving the agenda by taking over from business and taxpayer lobby groups. Unlike provincial and national governments, city governments are less partisan, and this provides greater freedom of movement – they can more easily sidestep criticisms based on ideology. Cities also function on a more manageable scale and are more flexible. ASD failures will likely accompany successes, but at the municipal level, failures are more limited in scope and more easily corrected.

- *Start now, but start small:* There is no single recipe for ASD that applies to all municipal services (Walker 1988). Each service has different incentives, constraints, and circumstances with differing financial, economic, and political considerations. ASD practitioners consistently advise that cities should begin with services that offer the highest

DISCUSSION BOX 4: Alternative Service Delivery

ASD PLATFORMS AND APPROACHES:

Contracting to other Governments
Contracting to the Private Sector
Contracting to the Community Non-Profit Sector
Contracting to Public Employees/Public Employee Bidding
Joint Public-Private Production and/or Delivery
Public-Private Competition (Managed Competition)
Franchising, Licensing, Concession, Vouchering
Road Tolls/Privately-owned Roadways
Employee Buy-Outs of Municipal Services
Competition for Least Subsidy
Competitive Maintenance Contracts
Capacity Contracting

POSSIBLE CANDIDATES FOR ASD:

Residential Solid Waste	Payroll Services
Commercial Solid Waste	Financial Services
Water Supply/Distribution	Social Housing
Sewerage	Homeless Shelters
Electrical Services	Libraries
Construction/Renovation	Museums
Inspection Services	Art Galleries
Janitorial Services	Public Golf Courses
Line and Curb Painting	Recreation Facilities
Snow Removal	Cemetery Maintenance
Recycling	Parking Meters
Street Cleaning	Municipal Parkades
Street Light Maintenance	IT Support
Street Repairs	Licensing and Permits
Traffic Signal Maintenance	Fees and Tax Collection
Garden Maintenance	Supplies/Inventory
Park Maintenance	Facilities Management
Mechanical Services	Fleet Maintenance
Public Conveniences	Assessment Department
Illegally Parked Vehicles	Animal Services
Public Transportation	By-Law Enforcement
Tree Planting	Municipal Zoo
Printing Services	Landfill Operations
Public Works Maintenance	Police and Fire Training
Employee Services	Radio and Dispatch

SOURCES: Oakerson 1999, Parsons 1994, Bens 1997, Walker 1988, Institute for Saskatchewan Enterprise 1990, City of Winnipeg 2000.

potential for success (Trebilcock 1994). These include services that are fundamentally predisposed to ASD conditions and those that tend to draw little public interest. As successes build and expertise and knowledge are gained, a solid foundation is built for future successes in alternative service delivery. It is important to establish success in an environment where there are more skeptics of ASD than fans (Institute for Saskatchewan Enterprise 1990).

- *Proceed slowly and steadily:* Moving quickly has the advantage of outflanking specific interests but most experts advise that a long-term, programmatic, and incremental approach is the best way to ensure success (Pirie 1987). Feasibility studies should precede each attempt at ASD. This is the process now being followed in Winnipeg, which has outlined a comprehensive program for alternative service delivery. In February of 1999, the City approved 15 candidates for ASD, of which animal services and solid waste collection are the furthest along (City of Winnipeg 2000). Whether Winnipeg will be successful in other attempts very much depends on its ability to sustain momentum for ASD over the long-term.

- *Begin developing a team and attracting expertise:* While cities must learn by doing, it is important to solicit the advice and expertise of individuals who have successfully practiced this form of public policy. These individuals can help craft specific techniques and offer advice on minimizing the misgivings of the public, union members, bureaucrats, and elected decision-makers.

- *Learn the strategies of ASD:* There are a number of strategies to cope with the challenges presented by alternative service delivery (Walker 1988, Pirie 1987, Goldsmith 1998). Two examples should suffice. To ensure good faith in the handling of competitive contracting, cities can insist on performance bonds from successful private sector contractors. Cities should always maintain a certain amount of in-house capacity for competitively contracted services. This prevents capture of the service by the private sector, ensures that a competitive environment is sustained over the long-term, and enables the city to take over a service if a private contractor defaults (Institute for Saskatchewan Enterprise 1990).

  To address the very real concerns of union members and managers, governments can commit to a no lay-off policy where successful private contractors interview former employees and offer them first right of refusal. Moving displaced employees and managers to different aspects of a city's operation can be combined with attrition, hiring freezes, and attractive severance packages (Walker 1988, Institute for Saskatchewan Enterprise 1990, Trebilcock 1994). Distributing a portion of the costs savings to employees and managers as a bonus and ensuring public workers can effectively bid on contracts has worked well in other jurisdictions. In Indianapolis, the city paid for consulting teams to provide employees and managers with the ability to bid against the private sector for the rights to provide a service (Goldsmith 1998). Workers also shared in some of the cost savings and successfully won 80% of competitive municipal contracts. Wages for municipal workers in the city actually increased as a result of ASD (Holle 1996).

OPTION #4: Enhance capital financing by expanding traditional sources and finding new and innovative streams of revenue.

The issue of infrastructure looms large on the urban landscape. Despite two multi-billion dollar tri-partite infrastructure programs, real per capita spending on capital has not kept pace in many cities (Vander Ploeg 2001a). When governments find themselves under fiscal pressure, the first expenditure to be cut is often capital. Capital spending is less visible than spending on programs and services, and it has fewer interests to defend it. As such, governments find it easier to neglect capital than to make the tough choice of determining which programs to cut (Parsons 1994). But insufficient investment in a city's capital stock eventually results in more than the inconvenience of traffic congestion. Although it may not be immediately felt, postponing maintenance and the acquisition of new infrastructure and technologies will eventually increase costs in the long run, reduce efficiency, and result in lost public and private sector productivity (Parsons 1994).

The difficulty with capital in the municipal context is the relatively narrow range of traditional funding sources, their inability to provide sufficient revenue, and practical as well as political limits to their expansion *(Discussion Box 5)*. For example, increasing the contribution made by current revenues and reserves (pay-as-you-go) implies an increase in property taxes, a significant reduction in reserves, or cuts in program spending to free up more money for capital. Utility and local improvement levies (amounts attached to utility bills and specific properties where improvements are occurring) are only a small source for most cities and are linked to specific expenditures. Increases in capital grants are clearly outside the direct control of cities. As a result, any significant expansion in traditional sources is primarily limited to an increased reliance on debt, higher charges levied against developers, and the sale of municipal assets.

DISCUSSION BOX 5: Capital Funding Options

TRADITIONAL APPROACHES:

Current Revenues and Reserves (Pay-as-you-go)
Debt Financing (Debentures)
Development Charges and Hook-up Fees
Utility and Local Improvement Levies
Senior Government Grants
Sale of Assets / Sale of Land Inventory

INNOVATIONS ON TRADITIONAL APPROACHES:

Earmarking Revenues and Special Levies
Tax-Free Community Bonds
Value-Capturing

NEW APPROACHES:

Public-Private Financing
Turn-Key Operations
Entrepreneurial Local Government

SOURCES: Vander Ploeg 2001a, Institute for Saskatchewan Enterprise 1990, Walker 1988, Tindal and Tindal 2000.

Each of these options would increase the amount of resources for capital. But the options are not limited to expanding traditional approaches. Cities can also innovate with these sources. For example, one innovation on debt financing is the tax-free community bond. With this tool, citizens contribute to their city by purchasing municipal debentures. The rates of the debentures would not have to approach market rates if the earnings on the bonds were tax-exempt. In addition, cities might consider earmarking user fees for specific capital priorities. Value-capturing is an extension of development charges that has been used in the United States. The idea is that business owners who realize an economic benefit (increased property value and business activity) from the development of local infrastructure share with the city a portion of the benefits they have received. Value-capturing can take a multitude of forms, but the basic idea is to share the benefits produced by a growing city through a revenue stream that acts as a wealth or capital gains tax (Institute for Saskatchewan Enterprise 1990).

Cities can also take advantage of new sources of revenue. The rationale behind public-private partnerships is to access capital via an alternative route to finance the infrastructure needs of civic operations and the construction of municipal facilities. Government acts as a facilitator by assessing the range of needs and prioritizing them. But instead of the city issuing its own debt and building, owning and operating a facility, the private sector is invited to develop a turnkey package. The private sector, consisting of an investment banking firm, a public accounting firm, and a large engineering firm, forms a consortium that finances, designs, constructs, then owns and operates a project on a long-term contract basis with cost controls built in. After the private sector has earned a return on its investment, the operation is transferred back to the city, which either assumes the operation or competitively contracts it out again (Walker 1988, Institute for Saskatchewan Enterprise 1990).

The notion of entrepreneurial government is the expansion of civic operations to include a profitable business component as a way to capture new revenue that is not dependent on increases in the property tax, special levies or grants. For example, the Milwaukee Metropolitan Sewerage District makes $7.5 million a year by converting 60,000 tons of sewage annually into fertilizer, and then selling it. The City of Phoenix earns $750,000 a year by selling methane gas captured from its waster water treatment plant (Tindal and Tindal 2000).

ADVANTAGES

- *Expanding and innovating with current capital revenue sources means cities are working within existing areas of financing authority:* Cities could always issue more tax-supported debt. A strong case can be made for more borrowing if debt levels are relatively low and the trade-off of not borrowing is an insufficient stock of capital. Development charges are already paid by builders of new residential and business properties to finance the infrastructure needs of expansion. However, it is unlikely that development charges alone cover the full cost of new development. Since sprawl remains an issue, an increase in these charges would more closely approximate the real costs of infrastructure in outlying areas. Many cities also own significant capital assets in addition to inventories of land that are being developed or held for resale. By identifying and selling non-essential assets, cities can realize a one-time source of funding or even create a pool of funds to generate a continual stream of investment income for capital purposes. Cities also currently earmark some user fees. Additional earmarking might make citizens more accepting of paying to fix infrastructure problems. Earmarking provides assurances that the user fees will go to something tangible rather than disappearing into a "black hole."

- *Appropriately distributing the costs of infrastructure:* Many cities are following a policy of "pay-as-you-go" for tax-supported capital projects such as road construction and

have restricted debt financing to self-supported operations such as municipal utilities (Vander Ploeg 2001a, City of Regina 2001, City of Edmonton 2000). But municipal tax-supported debt does not mean the same thing as provincial and federal tax-supported debt. Municipal debt is issued to pay for items that provide long-term benefits (infrastructure) while provincial and federal debt is issued to pay for more short-term benefits. In the municipal context, debt financing is both fair and legitimate for infrastructure investments that can last for generations. Debt shares the costs between the generation doing the building and future generations who stand to benefit from what that debt has helped build (Vander Ploeg 2001a).

- *Sharing the risks and rewards of building cities with the general public and private sector investors:* Community bonds and private-public partnerships allow cities to spread the benefits of building their cities. The advantage to the city of community bonds is borrowing at a lower rate of interest. The advantage to citizens is an opportunity to participate in the building process through a relatively stable and tax-free investment. By employing private capital, varying portions of the costs, risks and rewards of constructing, expanding and refurbishing infrastructure are also shared (Seidle 1995, MacDonald 2002). The advantage to the city is the completion of projects at a reduced cost with less public money, freeing dollars for investment elsewhere. The advantage to the private sector is the relatively low risk of a project supported by government and a reasonable return on its investment.

- *Private financing of municipal infrastructure has a long history and is becoming increasingly popular in American, European, and even Canadian cities:* For example, in the French *affermage* and *concessionaire* system, the private sector finances and operates, at its own risk, all facilities for drinking water. At the termination of the concession, the systems are returned to the public authority for another round of competitive contracting (Institute for Saskatchewan Enterprise 1990). Private contractors are required to return facilities in good repair. Worn-out equipment, as well as the original capital construction costs, must be covered over the period of the concession. In 1995, the regional water district of Hamilton-Wentworth in Ontario entered into one of the largest public-private partnerships of its type in North America when it signed a 10 year $87 million contract with Philip Utilities Management Corporation for the operation of its sewage and water treatment facilities. The contract included a no-layoff condition and guaranteed the region a minimum savings of $500,000 annually. The agreement also stipulates that the contractor will share 40% of any profit over $1 million annually with the Region (Tindal and Tindal 2000). A significant potential benefit from these arrangements is the broader management expertise and experience that contractors may bring.

DISADVANTAGES

- *Expanding and innovating with some traditional approaches essentially amounts to a tax increase:* Increasing development charges, value-capturing, and earmarking additional user fees will eventually cost users of municipal services. While all these options may be more palatable than a general mill rate increase, it is increased taxation nonetheless. Increasing the overall level of taxation in an environment where international competitiveness is increasing would be counterproductive.

- *Many options carry other negative implications:* The obvious disadvantage of increased debt financing is the growing interest costs that can squeeze out other program and future capital priorities. Increased development charges could result in a lower stock of affordable housing, an issue facing many cities already. Earmarking user fees may involve increased administrative costs (e.g., accounting, auditing).

- *Most options have limitations:* Many cities currently conduct the majority of their borrowing from provincial agencies (e.g., Alberta Municipal Financing Corporation and BC Municipal Finance) that may offer lower rates of interest or rebate part of the interest costs through conditional grants. As such, the savings offered by community bonds may be overstated. The liquidation of assets, of course, only works when they are no longer needed, and where there is a group of interested buyers willing to purchase. If there is a lack of interest, the assets can only be sold when the prices are very attractive, meaning the city will likely not get full value. Disposing of land inventory also implies the presence of a market, and also has to fit with a city's overall land development policies. Partnerships are often experimental and fragile, and some argue that they have not been as fruitful as originally hoped (Seidle 1995).

BARRIERS TO CHANGE

- *No alternatives are free:* A barrier hitting on virtually all options is the fact that none of them are free. To be sure, an option might not involve a specific tax increase, but many options certainly involve other costs that need to be paid. For example, tax-free community bonds would result in foregone tax revenue for both the federal and provincial governments. Because private capital will only flow to projects where the rate of return matches the relative risk, the private financing,

construction and operation of municipal facilities and services will likely result in higher user fees to ensure an appropriate return for the private investors. While this presents an obvious opportunity for a move toward more rational pricing, it may also be a political liability for governments. Even the notion of entrepreneurialism is affected. Aside from the conventional wisdom that governments should not operate businesses, certain private sector interests could lodge complaints about government competition and unfair advantage. Because they involve a cost to someone, groups will lobby to prevent the adoption of many options.

- *A preoccupation with debt, deficits, and tax reduction limits public appeal of the debenture option:* The current fiscal scene is dominated by a preoccupation with tax reduction, a ban on deficits, and paying down debt. The mantra of deficit and debt reduction makes it politically difficult for cities to expand this traditionally-accepted option.

- *Restrictions on the autonomy of cities block many innovations:* For example, a community bond program would likely require provincial approval, and other regulations might control the set up of user fees and the issue of earmarking. It is also likely that provincial legislation restricts the ability of cities to enter into certain public-private partnerships or to create public-private development corporations.

- *City governments may be unwilling or unable to make the compromises necessary to attract private partners or create entrepreneurial government:* While provincial control remains an issue, a more significant barrier rests with cities themselves. An effective and useful partnership is more than a consultative or collaborative effort. Whether or not the potential of private capital can be harnessed very much depends on creating the conditions that will attract the private sector. An effective partnership is more than joint action – it includes elements of power-sharing and a strong sense of mutual benefit (Seidle 1995). In other words, cities need to be willing to delegate some authority and control to the private sector partner who needs at least some freedom to recoup its investment. In the Canadian context, it is often the private sector that approaches governments to explore a potential partnership, and it is the private interests who request government funding, borrowing, or a loan guarantee. This is backwards, and reflects the desire of governments to stay in control as well as their tendency to underestimate the return required by private capital relative to the risks involved. With regards to entrepreneurship, a lack of expertise and incentives are likely the largest barriers. Public managers and employees are not business people. In many ways, entrepreneurial government requires a shift in the culture of municipal government organization.

FACILITATING CHANGE

- *Press the case for the uniqueness of municipal borrowing and begin working through the subjective question of tolerable debt levels:* Eliminating all tax-supported debt should not be the ultimate aim of financial planning at the municipal level. Of course, cities need to ensure that debt levels are sustainable and can be sensibly tolerated within the operating budget without crowding out other civic expenditure priorities. What is needed is a workable balance between the "pay-as-you-go" approach and the issuing of debt. Cities can press their case with the public by pointing out the obvious. For example, interest payments that consume less than 1% of the operating budget (Saskatoon in fiscal year 2000) may be too low. On the other hand, interest that consumes over 20% of the operating budget (Calgary in fiscal year 1990) is too high (Vander Ploeg 2001a). Cities can take advantage of the fact that many western cities are now revisiting the issue. The mayors of Edmonton and Calgary are now opening debate on an increased level of tax-supported debt, and the City of Saskatoon is also considering new borrowing (O'Donnel 2001, *Calgary Herald* editorial November 12, 2001).

- *Front-end development charges and other user fees whenever possible:* Simply increasing development charges presents a number of hurdles. However, there may be other ways to tap this source. The concept of "front-ending" allows infrastructure to proceed in advance of development. For example, developers in Calgary's southwest recently loaned $30 million, interest free, to the City for transportation infrastructure. In exchange, the City lifted a development cap (Heyman 2001). With this approach, cities will have to stress that the desire is to secure better timing for receiving funds – the approach is not a covert plan giving developers the right to set municipal planning and land use policies or to exploit the city's monopoly position on development approval.

- *Link ASD and capital funding:* Shifting to alternative service delivery options would likely free up assets that could be sold to provide capital funding. This option relates to the prior discussion over EdTel and Enmax *(Discussion Box 1)*. If infrastructure and capital investment are the critical issues facing cities, then a premium needs to be placed on liquidity. Everything needs to be "put on the table" to ensure that resources flow toward priority areas. Less inventory, materials, equipment and supplies lowers costs and frees up resources (Parsons 1994).

- *Realize the potential of the private sector and begin making the case that citizens, government, and the private sector must build together:* Recent efforts at municipal legislative reform in some provinces could be easing restrictions on the ability of cities to establish joint development ventures with private companies (Lorinc 2001). With one barrier apparently weakening, the primary barrier remains the desire to retain control within city hall. This approach must be reconsidered. The potential of joint development agencies and public-private corporations with wide latitude to reinvest in urban infrastructure, revitalize downtown cores, and rebuild harbour fronts is occurring the world over (Lorinc 2001).

- *Reward Entrepreneurialism:* Establishing a system of specific rewards and incentives in the form of salary bonuses, profit-sharing schemes, and promotions for managers and employees can stimulate ideas for cost savings and potential sources of new revenue. The critical ideas that drive entrepreneuralism in the public sector will come from the bottom-up rather than the top-down. Local governments need to capitalize on their strongest asset – the value and experience of their employees. Employees need to be given the room to make suggestions. Financial incentives can then be put in place where employees are encouraged to work toward getting those suggestions implemented.

OPTION #5: Provinces need to help cities by assuring a stronger municipal revenue base and freedom to innovate.

The momentum of urbanization, steadily increasing demands for local services, and the ill-defined structure of municipal functions are often blamed for municipal budget difficulties. But a more important factor is the limited growth exhibited by municipal revenues (Vander Ploeg 2001a). This is a direct result of the nature of municipal revenue sources and their lack of diversity.

Canada is currently among the five OECD countries most reliant on property taxes (Smith 1997, MacDonald 2002). While the property tax has a number of advantages, these are offset by significant disadvantages *(Discussion Box 6)*. The most obvious and detrimental is a lack of buoyancy. The revenue generated by any tax is a direct function of the tax base, the value of the base, and the rate that is applied. For the property tax, the base is the total assessed value of real property. This base broadens slowly, often at less than the rate of inflation. Increases in the value of the tax base are captured only when a reassessment occurs. In some cities, reassessments are relatively infrequent (City of Regina 2001) although with the introduction of market value assessment more cities are updating assessments annually (City of Edmonton 2000).

DISCUSSION BOX 6: Nature of the Property Tax

The property tax is the staple of municipal budgets, and in many ways it works well. The tax base is immobile and stable, which assures a reasonable level of compliance and yields consistent and predictable flows of revenue. The tax is highly visible which provides for accountability. The computation and collection of the tax are also straightforward.

However, the tax base is narrow and links to only one aspect of the economy. The tax is unrelated to ability to pay, and may also violate principles of fairness. Typically, the tax is not uniformly applied on a consistent basis across all properties – there is often discrimination in assessed values with differential effective tax rates based on property class rather than value. For example, residential properties are usually under-assessed relative to business properties, apartments are over-assessed relative to single family homes, land values tend to be under-assessed, and newer residences and buildings are over-assessed relative to older ones. Regular assessments would help solve some of these problems, but can be costly. In addition, some differentials are structurally built into assessment legislation.

Administration of the tax presents a number of problems. Unlike the personal income tax or a sales tax, there is no absolute measure of the value of the tax base. The value of property is estimated through a process of assessment, which can be disputed. While some argue the tax is also regressive, that depends on particular assessment practices and the availability of tax credits, deferrals, exemptions, reductions and refunds. Economists have argued that the property tax is likely regressive at low income levels, proportional at middle income levels, and progressive at high income levels. Most important, the property tax is inelastic. It does not grow in a way sufficient to cover growing municipal expenditures.

SOURCES: Loreto and Price 1990, McCready 1984, UNSM 2001.

When a city's tax base expands slowly and the full increase in the value of the base is not factored into the annual tax equation, the city must constantly increase the property tax rate simply to compensate for inflation, never mind increasing the amount of revenue they receive in real dollar terms (UNSM 2001). In the media and the minds of the public, this is equivalent to a tax increase. What is conveniently forgotten is that a portion of the increase is accounted for by inflation, and a portion of it is likely offset by increases in incomes (Loreto and Price 1990). The high visibility of the property tax, combined with the need to continually fiddle with the mill rate, can place municipal officials at a significant political disadvantage. City governments, fearing public backlash, are hesitant to increase the property tax rate such that it provides sufficient revenue (McCready 1984).

Senior governments, with access to personal income taxes, corporate income taxes, sales taxes and excise taxes do not face this problem. As long as the economy continues to grow, the base and value of these taxes increases sufficiently from year to year. The rates do not have to be constantly adjusted upward to yield steadily increasing revenues. For example, the base of a sales tax increases annually as more goods are purchased. The value of the base increases with the value of the goods and services sold. In addition, the rate always captures the effects of inflation, which are reflected in the prices of the goods or services consumed. City governments are not afforded this luxury.

User fees form a second source of revenue, but these too have limited potential for growth. While user fee revenue will increase as more people use city services, any net revenue gain is offset, in whole or in part, by the increased costs of providing more services. For user fees to contribute meaningfully to an increase in total revenue, city governments would have to again intentionally and substantially increase fees relative to the costs of a service.

Grants are the third major source of municipal revenue. Any growth in grants, however, is completely out of the hands of city governments, and they have also been significantly reduced in the last ten years (Vander Ploeg 2001a). Rather than forming an increasing and predictable source of funding, grants have become more ad hoc and limited to one-time infusions. For example, in 1999, the Province of Alberta agreed to rebate a portion of the provincial fuel tax to the Cities of Edmonton and Calgary. The rebate amounted to 5¢ per litre of fuel sold in the cities. In the fall of 2001, in response to falling natural resource revenue, the Province unilaterally reduced the rebate to 4.25¢ resulting in a loss of some $12 million for Calgary alone (Wilton 2001). Such fiscal sideswipes show the deficiencies of the current granting regime in sustaining quality and steady urban development.

Only the provinces can ensure that municipal revenue-raising capacity better matches expenditure responsibilities. To mend the growing fiscal gap, provinces first need to consider providing cities with access to new tax tools or creating innovative revenue-sharing formulas that capture the growth potential of other taxes. Second, provinces could relax legislative restrictions so cities can innovate with current revenues and experiment with new service delivery options.

ADVANTAGES

- *Ensuring better revenue growth:* An expanded set of tax levers that included personal income tax and a local sales tax would produce more robust growth in municipal revenues. Such taxes would provide local governments with better access to the wealth generated within their cities. Most important, revenues would grow based on the vitality of the tax base rather than the need to constantly increase property tax rates.

- *Limiting distortions and non-neutralities:* No single tax is entirely fair or neutral with regards to investment patterns or decisions about location and other business inputs. A powerful argument for a diversity of tax tools is that the non-neutralities and disadvantages produced by one tax can be offset by the presence of other taxes (Kitchen 2000). So while city officials could ignore political pressures and push ahead to ensure that the property tax provided sufficient revenue, this would likely aggravate the particular distortions of the property tax beyond a tolerable level. The combination of personal income taxes, sales taxes, resource taxes and excise and custom taxes likely means the totality of the Canadian tax system is well balanced. But this does not help cities that must rely primarily on the property tax.

- *Controlling externalities:* The taxation of property is logical for providing local services to local residents, whether individually or collectively. However, it is much more difficult to defend the property tax as a means to finance income redistributional activities or services that benefit residents of other communities, such as visitors and commuters (Kitchen, 2000, 2002c). Because it is impossible to completely disentangle cities from at least some income redistributional activities, and externalities remain a continual challenge, an expanded set of tax tools would go a long way in providing fiscal relief. A local hotel tax or sales tax would capture the services used by visitors and tourists. A personal income tax deducted at source would ensure that commuters also contributed to the costs of the services they consume.

- *Leveraging capital financing:* Sluggish revenue growth is a double-whammy. Not only do city governments face a structural fiscal gap, slow growth in revenues limits their ability to debt finance capital expenditures. When revenues expand at a reasonable and consistent pace, governments can leverage some of that growth with modest amounts of debt without overly burdening the operating budget. If revenues grow only slowly, the interest that accompanies any

increase in debt could consume more and more operating revenue. Because municipal budgets are very capital intensive, a more buoyant set of revenues would be very beneficial, allowing for more "pay-as-you-go" financing as well as debt financing of badly needed infrastructure (Vander Ploeg 2001a).

- *Furthering Innovation:* A key advantage of federalism is the presence of numerous levels of government that are free to experiment with solutions to pressing political and economic questions. A major structural impediment to innovation at the municipal level is the current form of provincial control over municipal activities. A relaxation of this control would unleash the creative and innovative capacity of cities. To be sure, mistakes will likely be made. But cities must be free to make these mistakes and learn from them. If cities are allowed to become policy laboratories, successes can be shared and even flow up to senior levels of government that arguably have less room to experiment.

DISADVANTAGES

- *Creating new tax distortions.* Allowing cities wide access to personal income taxes and sales taxes could create new and unwanted distortions. The non-neutralities of municipal sales and income taxes can be significant, and some argue they are simply inappropriate at the local level (McCready 1984). For example, if a city decided to levy its own local sales tax, it could stimulate a major shift in consumption patterns as shopping gravitated to non-taxing jurisdictions. A locally imposed personal income tax could lead to an exodus of jobs (McCready 1984). Such was the case with a 3% personal income tax levied by New York City, which was blamed by some for providing firms with a stimulus to move their operations across the river to New Jersey (Tullock 1994). Advocates of new tax tools argue that cities should be free to experiment and compete with a range of taxes as well as different levels of taxation. But the existence of competing jurisdictions down the road makes this difficult. The relatively small size of cities and the presence of other competing cities means such taxes may be too easily avoided. Cities might find themselves compelled to move back to the property tax simply because of its immobility (Tullock 1994). Obviously, this would be self-defeating.

- *Revenue-sharing can reduce accountability:* The problems of a locally-generated personal income or sales tax can be overcome if the taxes are levied by all municipalities across a city-region with minimal tax rate differentials. Such alignment would likely be difficult to achieve, and it would limit the benefits of intermunicipal tax competition not to mention the autonomy of cities to set local tax rates. The typical solution, then, is for these taxes to be set and levied province-wide. The amounts are then rebated to cities through a specific revenue-sharing formula. While this would overcome some of the distortions, it could lead to problems with accountability. Whenever revenue and expenditure decisions are made independently, accountability becomes muddled and the system tends to allocate resources less efficiently (Kitchen 1993).

- *Effects of recession:* Personal income taxes and sales taxes are more elastic than property taxes. As such, they are also more vulnerable to the ups and downs of the economy. Municipal budgets that were heavily reliant on these types of taxes could find themselves with severe revenue shortfalls during economic downturns. As such, an argument can be made that these taxes should supplement the property tax rather than completely replace it.

- *Loss of the provincial interest in municipal affairs:* A general loosening of provincial control would clearly be advantageous to cities but not necessarily provincial governments. It is important to realize that the provincial interest in municipal affairs is not driven by malice, but their responsibility over the integrity of local government. For example, provinces are ultimately responsible for the debt issued by municipalities. As such, it is not completely unreasonable for them to also have a say as to what constitutes an accepted level of debt.

BARRIERS TO CHANGE

- *Revenue competition:* The current economic climate coupled with the threat of a return to deficit financing at the federal and provincial levels means provinces and the federal government are not predisposed to parting with specific tax points or more grants. Public demands for health and education expenditure continue to make themselves felt. These priorities are already straining senior government budgets. At the same time, senior governments have shown a strong desire to favour tax relief. Any proposal for the sharing of tax room or an outright increase in the total level of taxation will fall flat.

- *Public perceptions:* In all likelihood, much of the Canadian public believes that the property tax is the only tax that naturally belongs to municipalities, despite significant evidence to the contrary (FCM 2001, Kitchen 2002c, Hollie 2001). Municipalities in Canada used to have access to locally generated personal income taxes and sales taxes. In 1935, for example, the City of Montreal introduced a 2% local sales tax and Quebec City followed in 1940. The sales tax was assumed by the province in 1964 (Kitchen 2002c).

- *The difficulty of striking a balance:* A key barrier to loosening the provincial reins is reaching an agreement on the specific areas where relaxation is both necessary and beneficial, and areas where the provincial interest needs to be protected or even enhanced. This is very much a subjective question, and striking the appropriate balance has proven elusive. Despite numerous attempts at municipal legislative reform, the agreements never seem to fully satisfy either the provinces or the municipalities.

FACILITATING CHANGE

- *Provinces need to get back to the fundamental rationale behind municipal grants:* Grants are not "gifts" intended to demonstrate benevolence. There is a complex economic rationale for grants. Generally, cities that rely heavily on the property tax are also dependent on intergovernmental grants (UNSM 2001). This is no accident. Unconditional grants are necessary for vertical equity. Vertical equity is the closing of the fiscal gap between revenues and expenditures that inevitably occurs when the property tax is the only tax tool available. Second, grants are necessary to provide horizontal equity between cities. Grants provide resources for those cities with an insufficient property tax base. Third, conditional grants are necessary to control significant externalities and spill-overs that naturally occur in large city-regions. Because outsiders do not pay into the local residential property tax, conditional grants flow to cities so they can provide services for non-residents without increasing the property tax burden on residents. A steady and predictable flow of intergovernmental grants is more than "greasing" the squeaky wheel. It forms part of the fundamental financing of cities.

- *Seek savings in the current granting system:* Finding efficiencies in intergovernmental transfers could provide a source of new revenue for both municipalities and the province without having to increase taxes. One option would be to move toward unconditional block grants and away from conditional transfers (FCM 2000b). With conditional grants, provinces have to spend money to create programs, cities have to invest time to review them and file applications, and both governments have to negotiate a final agreement. But reducing such administration costs is only one benefit. Unconditional grants would also heighten local government autonomy and reduce the deadweight loss that occurs when local priorities are shifted through cost-shared dollars. When priority needs are redirected to projects that are less desired, it could result in a misallocation of resources and reduced efficiency.

- *Formalized revenue-sharing agreements that capture personal income tax revenue, sales tax revenue, corporate income tax revenue, and fuel tax revenue would solve many problems:* The current unpredictability of the granting system has led to needless conflict and frustration for both cities and provinces. To ensure a level of granting that is sufficient and predictable, provinces and cities should seek agreement on a formalized system of revenue-sharing that acts as an effective tax point transfer that cannot be unilaterally altered. This would provide cities with indirect access to a much wider range of tax revenue. Such a system would avoid the problems associated with locally-generated sales taxes and personal income taxes. To be sure, provinces are hesitant to earmark specific revenues fearing a loss of flexibility. However, the rationale for such a system is not the "locking-in" of a provincial expenditure – it is revenue-sharing. Clearly, issues of accountability would remain. But that may be the trade-off required to avoid the perils of less workable options.

- *Provincial support for revamped revenue-sharing is necessary. But only the cities can move the agenda forward:* Much of the discussion over municipal financing revolves around increased revenue for city governments. Implicit in the discussion is that somewhere down the road there will be an increased level of taxation. But this is a bad fit with the policy environment. Calls for removing education funding from the property tax or taxing previously exempt properties go nowhere because it necessarily amounts to more taxation coming from somewhere. Arguably, such ideas also amount to a half solution. The amount of property tax room is only part of the issue. The more important issue is the inadequacy of the property tax itself.

To sidestep objections, cities must be willing to sacrifice revenue now as an investment in a more stable and growth-oriented stream of revenue in the future. For example, a city could commit to a significant one-time reduction in the property taxes they collect. As a result of negotiations with the province, a new revenue-sharing agreement (based on some combination of personal and corporate income tax points, as well as portions of the fuel tax and provincial sales tax) would come into effect. To ensure a win-win situation for taxpayers and the province, the revenue-sharing would not make up the entire difference in lost revenue. Cities would trade-off lost revenue now to secure more consistent revenue growth in the future.

A new commitment to revenue-sharing needs to go beyond the modest approaches relied on in the past and models now at work. For example, British Columbia used to provide municipalities with a 1% share of both the personal and corporate income tax and a six percent share of other taxes (UBCM 1993). The current Manitoba model provides municipalities with a 2.2% share of personal income tax and corporate income tax revenue (City of Winnipeg 2000). Contrast this with other jurisdictions. All cities in Arizona receive a 25% share of the state sales tax. Phoenix alone receives 33% of the total amount provided to municipalities because of the size of its population. This, combined with a separate local sales tax, generates 45% of revenue for the City of Phoenix (Holle 2000). A local income tax is the principle tax source for cities in Sweden. German cities have access to corporate income tax revenue as well as a constitutionally protected share of 15% of personal income taxes. Property taxes are relatively unimportant. In Denmark, cities also have access to a local personal income tax. Each municipality sets its own rate and the tax is deducted at source. It is collected by the central government and then rebated. Municipalities also receive 20% of the central government's corporate income tax revenue. Cities in Japan have access to over 17 different types of taxes (UNSM 2001).

In short, there is no reason for Canadian cities to rely so heavily on the property tax. There are good reasons to lower the tax and then augment it with significant sources of other revenue. Given the nature of the property tax, it is not impossible to imagine at least some support for a significant move toward another set of tax tools. Only cities, however, can ensure that the move is a "win-win" for everybody.

- *Provinces can help cities that are not currently doing so, to move to rolling property tax reassessments:* In the late 1990s, many provinces required cities to move to market-based assessments in order to provide more equity in the property tax system. Provinces could make another valuable contribution by providing funds to help cities move to "rolling" reassessments. A one-time inventory of all properties would be taken. By monitoring real estate transactions and employing sampling procedures, all properties of a specified class in specific areas of the city could be reassessed annually, allowing the property tax base and its value to climb. This would draw a closer connection in the minds of the taxpayer between property values and taxes paid. Since cities would no longer have to continually increase mill rates, it would allow them to escape the sometimes fictitious charge of "always increasing taxes."

- *For cities, the timing may be ripe for a concerted effort to secure a relaxation of restrictions:* Cities could move to link their frustration with declining grants and a lack of authority to similar provincial frustrations with the federal government over healthcare. The federal government's share of health costs has dwindled throughout the 1990s, yet its rhetoric and unilateral control through the Canada Health Act is preventing provinces from experimenting with new approaches. Given that the provinces are lining up against this sort of federal unilateralism, cities may be well-placed to press their case in the public arena by pointing out the obvious double-standard.

- *Provinces can rethink their interest in local government affairs and the means by which it is carried out:* The provincial interest needs to shift from the traditional concern of preventing local governments from making mistakes. The primary provincial interest now lies in ensuring that cities can continue to drive economic growth and increase living standards. The *fact* of provincial control is not the issue. The problem is the *detailed* method of control that precludes certain actions, fosters inertia and stifles initiative. Provinces need to restrain the urge to move in and correct every alleged municipal problem. Rather, provinces can establish a system of general controls that addresses the critical need to maintain a healthy municipal sector while avoiding detailed regulations. Whether it is called "natural person powers," "city charters" or "home rule", many countries are now seeing the advantages of placing cities at a half-way point between full constitutional recognition and their current status quo position.

CONCLUSION

Urban areas are quickly becoming an ever more important aspect of Canada's political, economic, and social fabric. In the last decade, there has been a qualitative and quantitative change in what citizens are expecting from their local governments. In many ways, these increased expectations may not be met with the current resources available to city governments.

If a growing fiscal gap is the bad news, the good news is that options to address the revenue squeeze faced by western Canada's large cities are not limited to increasing property taxes, arbitrarily hiking user fees, or cutting programs and holding back on capital. There are a wide range of policy choices that point in other directions. Cities can focus on core priorities, link user fees to the costs of their services, reform the property tax system, and seek out more effective and efficient methods of delivering their services. Senior governments can pave the way by helping cities employ innovative means of capital financing and securing new opportunities for a much different set of revenue tools that promises more potential for growth.

These options have been on the table for some time, and have been exhaustively discussed and debated. But the barriers to change are significant and progress is slow. What is needed is a concerted effort by Canadians and all levels of government to tackle the tough issues of urban finance.

Cities lack the political clout to effect change, being under-represented in both provincial legislatures and the national parliament. As such, residents of the cities need to assess their stake in the range of urban issues and begin casting their provincial and federal ballots accordingly. Only when the political power of the West's cities begins to match their economic power will fundamental change be forthcoming. But Canada may not be able to wait that long. Cities themselves must work harder to build their case and develop a compelling rationale to address the deficiencies in their finances. The need for an informed public is critical.

For their part, provincial governments need to work harder to ensure that cities can operate freely in an environment that stimulates and encourages innovation. Provinces also need to provide access to more adequate sources of revenue. A failure on the part of provincial governments in this regard could very well result in cities turning to the federal government for relief. The prevailing assumption is that municipal affairs remains solely in the provincial realm, but matters of fundamental national economic interest can still unleash the federal spending power. Because another messy intergovernmental dispute would hardly contribute to solving the problem, part of the answer may lie in building on the goodwill generated by the previous tri-partite national infrastructure programs. A cooperative approach, with the three governments working in tandem, offers more promise.

All of the options put forward here will not find unanimous support. But one thing is clear – each time an option is deemed unpalatable or unworkable, the field of choices necessarily narrows. It is very much an imperative that Canadians and their governments make at least some new ideas work. If we are not up to the collective challenge, then Canada faces only one other option – the status quo. As far as city finances are concerned, going cap in hand to the provincial and federal governments will remain the primary modus operandi.

But if well operated, highly livable, and appropriately financed cities are the comparative advantage of the 21st century, siding with the status quo could be even more ugly. The status quo means that Canadians and their mayors, premiers, the prime minister and Canada's many city councillors, MLAs, and MPs have chosen to preside over a slow and gradual, but steady and inalterable decline in the quality of life and the standard of living now afforded by this country. It is prophetic now, but the initial warning was sounded by Thomas Kierans 15 years ago:

> *"At some point, the federal government is going to download a large part of the expenditure problem onto the provinces, who in turn will offload it in part onto the municipalities. Since the municipalities are not in a position to print money on the one hand, and certainly don't have the borrowing capacities of the provincial governments on the other, that is going to be where the rubber is really going to meet the road."* *(Walker 1988, 144)*

Indeed, the rubber has hit the road. But the skid marks are leading toward the ditch. Steely determination, a steady hand on the wheel and the right touch on the gas, the brake, and the clutch might just keep the bus on the road – perhaps even a toll road. ■

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